The All-Party Parliamentary Group on Microfinance

The Microfinance Debate: 19 October 2010

Debating the Question of Whether Microfinance is an Effective Tool to Help Eradicate Poverty

For: Dr Martin Greeley, Research Fellow, Institute for Development Studies
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Against: Dr Milford Bateman, Research Fellow, Overseas Development Institute
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Chair: Annette Brooke MP, Chair of the APPG on Microfinance

Summary of arguments for and against

Microfinance is an effective tool to help eradicate poverty	**Microfinance is not an effective tool to help eradicate poverty**
• The MF sector is thriving and healthy. There would not be such a high demand (e.g. 10-20 million borrowers in Bangladesh and similar numbers in India) if MF didn't work or had something fundamentally wrong with it. • Initial public offerings (IPOs) show MF is working. Successful IPOs are a testament to Microfinance Institutions (MFIs) becoming sustainable institutions.	• MF has become an industry through inertia and greed. • The commercialisation of MFIs in Mexico and India shows the potential for people to make huge profits from initiatives that tend to start up with social money. In Mexico, Comportamos' IPO a few years ago was valued at $1.2 billion. Similarly with SKS in India, the initial promoters pocketed $56 million each. • The high saturation of MF has led to a boom and bust. MFIs see there is money to be made and have created a sub-prime style dynamic that can't be controlled. • As an example of this boom and bust, in Nigeria 841 MFIs have been set up in the last 4 years. However, 242 licences have been withdrawn in the last month because people went into it thinking they would become commercial, mainstream banks.
• MF is now a diverse, well-developed sector with different players and different models. • There is increasing recognition that there are different beasts operating under the name of MF. It is important to recognise the diversity of practice. If an MFI is concerned with poverty reduction, it has to move with purpose and have a theory of change about how to reduce poverty.	• Commercialisation hasn't completely taken over the MF industry but this is the dominant model preferred by development organisations and will become the standard. • 'MF capture' has taken place. Social institutions are rapidly being captured by international capital, IPOs and would-be millionaires. People who start with social motives can still go down the route of

• There are two groups of advocates who argue in favour of MF as a tool to alleviate poverty. The first group values MF because it leads to greater financial inclusion and enables more people to access financial markets. This is grounded in the assumption that a stronger financial sector leads to economic growth which in turn leads to poverty reduction. • The second group has a different theory of change and values MF because of its direct impact on the household welfare of clients. MF is a significant contributor to the welfare of poor clients.	profitability.
• The original concept of MF is the right one but has got obscured. • Muhammad Yunus, the original pioneer of MF is critical of some of the developments in the field, especially the superprofits made from privatising MFIs. This is inconsistent with the original mission of MF. The original pioneers of MF weren't concerned with sustainability but with what kind of interventions would benefit households of clients. • A major concern for many MFIs is gaining access to money markets for growth – access requires good financial performance and financial sustainability. • The MF agenda has been hijacked by those who are focused on access to financial services and extending scope of financial markets through MFIs. They have little to say about the direct impact of MF on welfare of clients. • There has been a related shift from donor to private finding of MF activities with a focus on the sustainability of MFIs rather than the impact of MF programmes on welfare. For example, DFID locates its MF work within private sector development. • If an MFI isn't sustainable it won't be able to serve poor clients well. However, a focus on sustainability should not be to the exclusion of concerns for poverty outreach.	• The original mission of MF was to reduce poverty through the expansion of, or opportunity to engage with income-generating activities. After 30 years, there is no evidence that MF has performed as it was originally set out to perform. • The village of Jobra in Bangladesh where Muhammad Yunus gave out his first loans is in as much poverty now as it was 30 years ago. • Individual entrepreneurship has nothing to do with sustainable development.
• MF is useful. The World Bank and others have done studies e.g. *Financial Diaries*, *Portfolios of the Poor*, showing that poor people can, want and do save money. They want to move money, borrow money to invest or to pay for consumption purposes and some want to insure themselves against certain risks. • People in the UK would struggle without such services and the same is true for the very poor. • Evidence from a 5-year research programme	• Randomised control trials published in 2009 suggest that clients got little benefit from MF. • MF has led to greater indebtedness of the poor. People who have multiple loans and businesses are more likely to fail and struggle to repay loans. • Studies in Andra Pradesh indicate that subsistence farmers get into high rates of debt. • Supporters of MF use stories and case studies to counter the negative outcomes of random control trials. Anecdotes about the positive

‘Money with a mission’ showed a positive impact of MF in many areas of household welfare e.g. increased income, improved earning patterns, consumption smoothing, building of assets, greater esteem and empowerment of clients and greater capacity to cope with crises. • There are many powerful stories which show how MF has impacted people’s lives. These are important for grounding theoretical discussions of MF. • Yunus and the Grameen Bank didn’t win the Nobel Peace Prize from making profit but because of the evidence that MF has had an impact on poverty alleviation.	impact of MF do not prove anything. As many anecdotes can be found to show the negative consequences such as people getting into debt, family break-ups, suicides etc. • Parallels can be drawn between Muhammad Yunus and the ‘Marlboro Man’, iconic figures who both market a product that is bad for people’s long-term health. • Organisations like DFID are now having to move into debt counselling to reverse the negative consequences of earlier investment in MF.
• MF is empowering: it enables people to do things with their money. People literally ‘walk taller’ as a result of accessing MF. • Women, in particular gain a sense of dignity from running a business or simply having the ability to choose how or when to save, borrow or invest. • A key advantage of MF is the concept of self-worth, enabling someone to take their own decisions, not relying on charity.	• MF pushes the responsibility of poverty onto the poor. It absolves governments and others of the responsibility to raise taxes or improve social welfare. For example, in Kerala local government have used the expansion of MF as an excuse for the lack of investment in medical services – if people have MF it is argued they can sort things out for themselves.
• Socially-minded MFIs do not want people to get addicted to debt. Many provide a lot of training to clients on financial literacy and business skills. • The growing trend is for MFIs to provide multiple products such as savings, insurance and money transfers rather than only providing loans. • There is great potential for innovation such as mobile banking to facilitate transfers and savings.	• A typical MF account is an expensive and limited product. There is usually just one type of account to choose from. Most do not take savings but may demand you to put money down as a guarantee. You may also be required to take out insurance to cover your loans which will increase the cost of your repayments. • Unlike other banks, MFIs don’t have to offer savings products. They can lend money at a high price and demand that loans are paid back quickly.
• Unlike other forms of development assistance, MFIs could continue if the tap of funding was to stop. Many are self-sustaining at an institutional and group level. Income-generating activities would not cease. • MF avoids many forms of corruption. Other forms of aid stick to people’s hands but MF does reach the people on the ground.	
• The traditional group model of MF provides transparency, accountability and peer support. When given the choice, many groups would continue to meet because of social value of coming together to share best practice, business ideas. • Opportunity International did a DFID-funded study in Ghana and Columbia looking at group-lending methodology. Women were not graduating out of groups to smaller groups then individual loans and wanted to	• To qualify for a traditional MF account you have to form a solidarity group and meet as a group once a week to discuss your private financial affairs. You need to choose the other members of your group carefully as these people will decide whether you can borrow money. If one person in the group fails to repay their loan you will all be liable for it. Most accounts are only available to women. • Whilst MF groups can be empowering they

know why women did not leave the groups. Most women interviewed said they didn’t want to leave groups because there was value in being part of a group beyond accessing capital.	can also add strains to existing relationships within a community. • High payback rates could actually be a problem. Some borrowers may in fact be playing the system with multiple loans or are selling last possessions in order to uphold solidarity of groups.
• MF is *micro* so we need to remember that changes might be small or generational. It may not be client but her/his children who reap the greatest rewards. • The fact that many microenterprises stay small is to be expected. Not every MF entrepreneur is going to become the head of a multinational company. Many clients are satisfied to earn a regular income that will enable them to send kids to school, etc, or simply to have a safe place to save money.	• There is no historical evidence that a proliferation of microenterprises has anything to do with sustainable development or poverty reduction. MF is not associated with growth in the Western world or other economies. • MF doesn’t understand economies of scale: there is no capacity for microenterprises to grow and become efficient and productive. Most microenterprises start small and end small. • There is no evidence that the growth of small and medium business originates in microenterprises.
• MF helps to eradicate poverty as part of a package of interventions. MF alone is not sufficient. It is not a silver bullet. • Rather than debating whether MF works or not, we should be looking at what *aspects* of MF do or don’t work. • MF is not the sole solution to elimination of poverty but social microcredit is of great value to many in the developing world and has an important role to play.	• MF is often oversold as the best kind of development intervention. • The impact of MF on poverty eradication will be limited without investment in other social services. • Mainstream MF is not a way to eliminate poverty. • The reality is that MF has been overblown and we expect too much from it.
• Randomised control trials didn’t look at the long term benefits of MF. They were looking at household income over 18 months and found a shortage of impact. Serious MFIs don’t make claims over this period. • Random control trials from 2009 are still flawed but do address problem of selection bias. 18 months not long enough to prove impact on social indicators e.g. health.	• Many evaluations of MF prior to 2009 have been flawed and disguise the negative net effect of MF in a community.
• In many places, the only alternative financial services are local money lenders. If MF can lend at decent rates then this is a positive alternative. • Mainstream regulated banks that serve poor with first rate products are the ideal. The long-term aim should be for MFIs to not be needed at all.	• MF is so popular only because there are few alternatives, not because of the quality of the product. • Other types of financial services can be provided to the poor. They may not be as profitable but will do a more effective job of poverty alleviation.
• MF is not an alternative to supporting small and medium enterprises (SMEs). • MF is not responsible for all the ills of capitalism. • Capital is essential for small businesses but there is a shortage of capital in Africa. MF is a good way in inject capital.	• 1990s neo liberalism and the Washington Consensus have resulted in commercialisers pushing for financial sustainability. This has led to high interest rates which have created a disabling environment for businesses. • The expansion of microenterprises often comes at the expense of existing businesses.

• Laws of contract and weak infrastructure in some countries are the real barriers to significant enterprise culture. Difficult for SMEs to develop without better infrastructure and governance.	• MF is almost entirely associated with expanding the informal sector. Many development agencies are in fact trying to stop the growth of the informal sector. • There is a need for institutions to link and support small entrepreneurs – for example, rather than encouraging lots of people to become tomato sellers, there should be support for the creation of a tomato processing plant which could employ many more people. Concerted support is needed to help businesses go up the value chain. • Need growth capital finance in Sub-Saharan Africa rather than MF. • The Intra-American Dev Bank has recently argued that Latin America is still in poverty after 30 years because too much of scarce resources have been invested in microenterprises and self-employment and not enough has been invested into SMEs.
• There is a good reason why most MF clients are women – they have much better repayment rates and part of reason for MFIs being profitable. • There is every reason for MF to focus on women because they are the ones who work hardest and are most discriminated against. • National production strategies tends to incorporate women as low paid labour.	• The role of women is frequently discussed at the anecdotal level but gender analysis is often dropped at the broader level. • Whilst there is evidence that individual sources of income can be empowering there is also evidence that MF can add extra burdens on women – is getting another job best solution when women are also collecting water, caring for the family, etc?
• In the UK, credit cards and private loans are around 20%. • Credit committees are impersonal and know nothing about their clients and whether they are reliable candidates for loans. This is part of the reason why banks in the West have undergone so many problems. MFIs have a much deeper relationship with their clients.	• Interest rates on MF loans are 4-5 times the price of a standard overdraft or mortgage in the UK. The average interest rate in India is around 30%. In other parts of the world, rates can be as high as 50 to100+%.